

# Memorandum

**TO:** HONORABLE MAYOR AND  
CITY COUNCIL

**FROM:** Larry D. Lisenbee

**SUBJECT: MONTHLY FINANCIAL REPORT  
FOR OCTOBER 2003**

**DATE:** December 11, 2003

Approved

Date

## INFORMATION ONLY

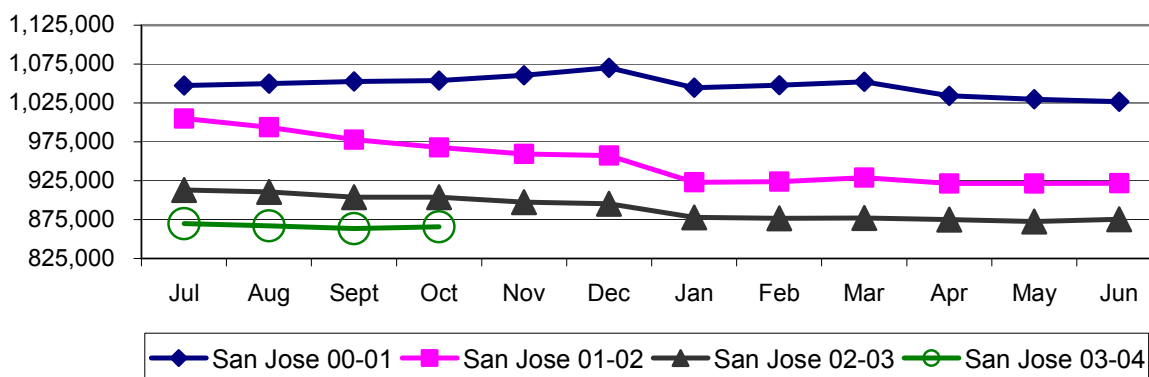
The Monthly Financial Report (MFR) for October was jointly prepared by the City Manager's Budget Office and the Finance Department and is presented here for the City Council's review.

## OVERVIEW

A review of the financial activity for the City in October and through the first quarter of the fiscal year serves to confirm that the City remains mired in a severe and persistent slowdown in the local economy, which in turn continues to negatively impact collections of most of the City's major revenue sources. Although the regions's economic situation appears to have stabilized somewhat, the signs of economic growth being seen both nationally and elsewhere in the State, are not yet being evidenced locally.

The most crucial indicator of economic health in our view continues to be the employment situation in the County, and regrettably, job losses still characterize our economy (see below).

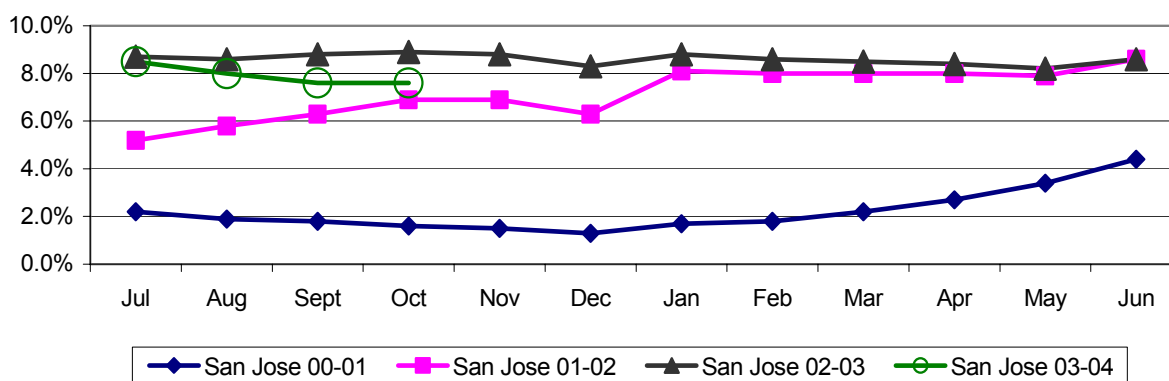
San José Metropolitan Statistical Area  
 (Santa Clara County)  
**Employment: Total Jobs Comparison**



## OVERVIEW (CONT'D.)

The October employment numbers indicate that while the rate of the drop-off in the number of jobs may have lessened, job losses continue to be the norm in the Valley, and we are not seeing any sign of the increases in employment that will be needed to pull us out of the current stagnant economic situation. October's unemployment rate of 7.6% was unchanged from September's adjusted rate of 7.6%, but the number of unemployed residents increased yet again, from 68,600 to 69,300. Even the one seemingly bright sign in the report (the number of jobs in the County ticked up slightly, increasing by 2,500, from 863,300 to 865,800), appears to be more a result of normal seasonal hiring patterns rather than any real indication of true growth. Even with this slight increase, San Jose has experienced an overall 4.1% decrease in jobs for the year. The County unemployment rate through October also remained well above both the State and national rates, which were 6.4% and 5.6%, respectively. An MBIA MuniServices October economic report summarized our situation quite well by pointing out that "the Bay Area in the past year has actually lost more jobs than the entire state, meaning that the rest of the state has added jobs even as this region continues to lose them."

San José Metropolitan Statistical Area  
(Santa Clara County)  
**Unemployment Rate Comparison**



The most dramatic illustration of the negative impact of the economy on revenue collections remains the General Fund's largest single revenue source, Sales Tax. The City most recent General Sales Tax information was again disappointing. September final Quarterly Sales Tax collections representing economic activity in April, May and June) were down 1.4% from the same quarter in the prior year. This was an unprecedented ninth consecutive quarter in which City Sales Tax collections declined. Though the percentage drop may not have been as great as the previous quarters, the news was still very discouraging, as the drop was from a poor prior year quarter that had itself been down by 16.7% from the 2000-2001 level. It should be noted, however, that the Administration had anticipated the weak performance by building a conservative 10.0% drop into the 2002-2003 fourth quarter accrual estimate. This actually allows the City to begin the new fiscal year with a small budgetary cushion in Sales Tax revenue. The actual collection level was, however, slightly below the level anticipated when the 2003-2004 estimate was constructed.

## **OVERVIEW (CONT'D.)**

In summary, therefore, on an overall basis, the first three months of the year continued to be characterized by the continuing weakness in key economically sensitive revenues. In addition, as described below, unanticipated problems in two key revenue sources, Motor Vehicle License Fees and Electricity Utility Taxes, will result in collections falling short of budgeted expectations in those two categories by approximately \$2.4 million. While noting how little data has been received to date, however, with the very notable exception of the potential loss of State Vehicle License Fees (VLF) resulting from the recent action of the new Governor (\$28 million), we believe that collections on an overall basis are performing very close to budgeted expectations. The loss of VLF funds would, of course, reverse that conclusion completely, and contingency planning has begun to develop options for the Council to consider should that loss prove unavoidable. The Council will be continuously updated on the status of our monitoring through these MFR reports as the year progresses.

It should be noted that in response to the continued weak economic performance, and in light of the projections for major budgetary shortfalls facing the City, the Administration is continuing to implement the aggressive cost control strategies that have been in place for well over a year. A city-wide hiring freeze continues to be in effect, as well as the freezes on various non-essential expenditure categories (e.g., overtime, travel, technology purchases, marketing, etc.). In addition, General Fund departments have been assigned Cost/Position Management Plans for the 2003-2004 fiscal year, which cumulatively total approximately \$9 million. These plans have been submitted and are under review by the Budget Office.

## **GENERAL FUND**

### **Revenue Collections**

General Fund revenues through October 2003 totaled \$169.8 million. This was an increase of \$5.6 million (3.4%) from the October 2002 level of \$164.2 million. This performance was primarily driven by growth in the Transfers and Reimbursements category (\$11.7 million or 34.1%) along with increases in the following revenue categories: Licenses and Permits, Revenue from the Federal Government, Departmental Charges, and Other Revenue. Growth in those categories was partially offset by decreases in the following revenue categories: Property Tax, Sales Tax, Transient Occupancy Tax, Franchise Fees, Utility Tax, Use of Money and Property, and Revenue from the State of California.

The following discussion highlights General Fund activities through October:

**GENERAL FUND (CONT'D.)**

**REVENUES (CONT'D.)**

**KEY GENERAL FUND REVENUES**  
(\$000's)

<u>Revenue</u>	<u>2003-2004</u> <u>Estimate</u>	<u>YTD</u> <u>Actual</u>
<b>Property Tax (Cont'd.)</b>	<b>\$ 92,438</b>	<b>\$ 10,866</b>

Year-to-date Property Tax revenues primarily reflect only collections in Unsecured Property Tax and the smallest property tax category, SB 813 Property Taxes (supplemental taxes).

Current and Prior Unsecured Property Taxes are driven by the value of personal property, typically equipment and machinery used by business and industry for manufacturing and production. Through October, Unsecured Property Tax receipts of \$10.4 million are 11.4% below last year's level of \$11.7 million. A falloff had been anticipated, and this performance is within budgeted levels. It should be noted however, that performance in this category over the past decade has been extremely volatile and subject to sharp changes as the economy shifts. Staff will continue to monitor this revenue source closely and work with the County to obtain additional information to determine whether adjustments might be needed before year-end.

With the adjustments for accrual reversals and timing differences, SB 813 payments through October of \$427,000 are down 31.2% from last year's comparable collections of \$560,000. Collections in this category, representing payments for taxes owed on recent housing re-sales, are typically a leading indicator of a drop in sales activities. The Adopted Budget also anticipated a significant decline in this category, although not that large. The budget presumes a drop of 10.0% from the prior year level. We will need to watch closely to ascertain whether an additional downward adjustment may be necessary later in the year.

Consistent with previous years, no payments for Secured Property Taxes have been received through October. Initial data from the County of Santa Clara indicates growth is currently at or above the expected level for 2003-2004. Staff is working with the County to confirm the preliminary information.

<u>Revenue</u>	<u>2003-2004</u> <u>Estimate</u>	<u>YTD</u> <u>Actual</u>
<b>Sales Tax</b>	<b>\$ 128,818</b>	<b>\$ 20,835</b>

General Sales Tax receipts for October represent only State formula advance payments. Collections of \$20.8 million tracked 7.9% lower than the \$22.6 million collection in the prior year. Because these are advance payments, however, the decline through October is not necessarily indicative of an actual drop in receipts.

**GENERAL FUND (CONT'D.)**

**REVENUES (CONT'D.)**

**KEY GENERAL FUND REVENUES**  
(\$000's) (Cont'd.)

<u>Revenue</u>	2003-2004 <u>Estimate</u>	YTD <u>Actual</u>
<b>Sales Tax (Cont'd.)</b>	<b>\$ 128,818</b>	<b>\$ 20,835</b>

The next actual receipt information, representing the first quarter collections of the fiscal year will come in late December. In September, the City received the most recent quarterly Sales Tax report from the State. As discussed above, and as reported in the 2002-2003 Annual Report, the City's collections levels continue to be weak, with a 1.4% decline from the same quarter last year, which represents our ninth consecutive quarterly decline in Sales Tax receipts. San Jose's decline was less than that experienced by the San Francisco Bay Area (down 2.3%) while the State as a whole actually grew (5.0%). The South Bay regional economy clearly continues to be the hardest hit area in the State, if not the nation.

Preliminary information from MBIA MuniServices, the City's Sales Tax consultants, indicates that the decline in the City's Sales Tax receipts for the most recent quarter can be attributed to poor performance in most economic sectors, but was led again, not surprisingly, by yet another decline in the Business-to-Business category (down 7.6%). The following categories also suffered significant drops: Transportation (down 6.3%); Construction (down 5.4%); and Food Products (down 3.9%). Within the Business-to-Business category, the greatest declines were related to leasing (down 26.7%), office equipment (down 11.6%), heavy industry (down 9.9%), and electronic equipment (down 5.2%). Within the Transportation sector, the greatest decline was in service stations (down 11.2%) and new auto sales (down 4.8%). The following lists the largest General Sales Tax sectors and their percentage of the total for the 2002-2003 fourth quarter (March through June economic activity): Business-to-Business at 27.5%; General Retail at 25.9%; Transportation at 22.0%; Food Products at 13.4%; and Construction at 10.2%.

<u>Revenue</u>	2003-2004 <u>Estimate</u>	YTD <u>Actual</u>
<b>Transient Occupancy Tax</b>	<b>\$ 6,719</b>	<b>\$ 1,134</b>

Transient Occupancy Tax (TOT) collections through October of \$1.1 million were below last year's level of \$1.2 million for the same period and 22.2% lower than the year-to-date estimate of \$1.5 million. This decrease indicates continued softness in this area with minimal growth expected the rest of the fiscal year.

**GENERAL FUND (CONT'D.)**

**REVENUES (CONT'D.)**

**KEY GENERAL FUND REVENUES**  
(\$000's) (Cont'd.)

<u>Revenue</u>	<u>2003-2004</u> <u>Estimate</u>	<u>YTD</u> <u>Actual</u>
<b>Transient Occupancy Tax (Cont'd.)</b>	<b>\$ 6,719</b>	<b>\$ 1,134</b>

The October 2003 occupancy rate in the largest hotels was 50.42%, down from both the October 2002 rate of 55.84%, and the September 2003 rate of 51.4%. An additional sign of continued weakness in the local hospitality market is the fact that while the number of rentable rooms remains relatively stable, the average room rate continues to drop, from \$127.27 in October 2002 to \$115.96 in October 2003. We will continue to monitor this situation, but believe that a further downward adjustment to the estimate for this revenue source will likely be required as part of the mid-year budget.

<u>Revenue</u>	<u>2003-2004</u> <u>Estimate</u>	<u>YTD</u> <u>Actual</u>
<b>Franchise Fees</b>	<b>\$ 32,406</b>	<b>\$ 7,353</b>

Collections of \$7.4 million from Franchise Fees were below the October 2002 collection level of \$8.0 million. This negative variance reflects net lower collections in Electric and Gas Franchise Fees and lower than anticipated collections from City Generated Tow Franchise Fees. The receipts related to Electric and Gas Franchises Fees are the result of formula-driven estimated payments from Pacific Gas & Electric (PG&E), based on actual collections in calendar year 2002, and are not necessarily indicative of actual expected receipts. In addition, as reported to the City Council in June 2003, net receipts also reflect the repayment of \$183,236 to PG&E for overpayments made to the City in 2002-2003. In April 2004, PG&E will calculate the actual Franchise Fees due in 2003-2004 based on calendar year 2003 activity. City Generated Tow Franchise Fees are anticipated to meet budgeted expectations.

Commercial Solid Waste Franchise Fees of \$1.9 million are flat when compared to the prior year level of \$1.9 million. Preliminary discussions indicate that this anemic performance is primarily due to the continued weak economic climate as well as to commercial diversion programs. Though it is still early in the year, preliminary estimates indicate that this revenue category may not meet budgeted expectations. The Budget Office will continue to work with the Environmental Services Department to analyze current year performance and assess whether a downward adjustment should be recommended.

**GENERAL FUND (CONT'D.)**

**REVENUES (CONT'D.)**

**KEY GENERAL FUND REVENUES**  
(\$000's) (Cont'd.)

<u>Revenue</u>	<u>2003-2004</u> <u>Estimate</u>	<u>YTD</u> <u>Actual</u>
<b>Utility Tax</b>	<b>\$ 66,979</b>	<b>\$ 18,096</b>

Utility Tax collections of \$18.1 million are flat compared to last year's level of \$18.1 million. This performance primarily reflects slightly higher collections in the Gas, Water, and Telephone Utility Tax, offset by lower collections in Electric Utility Tax. The projection for a shortfall in the Electricity Utility Tax is the result of a September announcement by the California Public Utilities Commission that it has ordered an unanticipated one-time rebate to PG&E customers. The negative impact of that rebate on the City is projected at approximately \$1.1 million. Although increases in natural gas prices and slight increases in overall usage have Gas, Water, and Telephone revenues tracking slightly higher than last year, it is not anticipated that this small increase can offset the reduction in Electricity. It is likely that a downward adjustment to this revenue category will also be required at mid-year.

<u>Revenue</u>	<u>2003-2004</u> <u>Estimate</u>	<u>YTD</u> <u>Actual</u>
<b>Licenses and Permits</b>	<b>\$ 66,748</b>	<b>\$ 22,403</b>

On an overall basis Licenses and Permits revenue of \$22.4 million through October was 18.7% above the prior year level of \$18.9 million.

Cardroom Business Tax collections of \$2.0 million were well above the prior year level of \$1.5 million. This performance was primarily driven by the Bay 101 bankruptcy filed in July 2002 where revenue was not received during that period. This revenue category is expected to meet budgeted expectations of \$7.5 million.

Disposal Facility Tax revenue of \$3.7 million was 9.7% lower than the prior year level of \$4.1 million. This reflects the fact that BFI and Waste Management have taken issue with the removal of the Alternate Daily Cover exemption approved by the City Council last year. Pending a resolution of this \$1.8 million dispute, by agreement with the City Attorney's Office, BFI and Waste Management are paying amounts related to alternative daily cover into an escrow account. The Budget Office will continue to work with the Environmental Services Department and the City Attorney's Office to monitor the status of this issue and its impact on City revenue collections.

**GENERAL FUND (CONT'D.)**

**REVENUES (CONT'D.)**

**KEY GENERAL FUND REVENUES**  
(\$000's) (Cont'd.)

<u>Revenue</u>	2003-2004 <u>Estimate</u>	YTD <u>Actual</u>
<b>Licenses and Permits (Cont'd.)</b>	<b>\$ 66,748</b>	<b>\$ 22,403</b>

Fire Permit revenues of \$2.3 million were flat when compared to the prior year's revenues. This performance was below the amount anticipated in the budget and current projections indicate that these revenues could end the year as much as \$1 million below the budgeted amount. This can be, however, partially offset by salary savings in fee program costs. The status of the Fire fee program will continue to be closely monitored and, if necessary, adjustments to the budgeted estimate will be recommended as part of the Mid-Year Budget Review.

Building Permit revenues of \$8.3 million, in contrast, are tracking well above both the budgeted level (28.0%) and last year's collection level (53.1%). Revenues through October collected in all categories performed at or above anticipated levels. A change in the building code that was effective on November 1 apparently resulted in an increase in October activity and revenues. It is expected that revenues will smooth out over the rest of the year.

<u>Revenue</u>	2003-2004 <u>Estimate</u>	YTD <u>Actual</u>
<b>Use of Money and Property</b>	<b>\$ 9,492</b>	<b>\$ 1,878</b>

As anticipated, the Use of Money and Property revenue of \$1.9 million in October was significantly below the prior year level of \$3.4 million, reflecting lower cash balances and interest earnings. The General Fund cash balance for October was down to \$136.9 million, as compared to the prior year's balance of \$186.6 million, a decline of 26.6% or \$49.6 million. This level was below that assumed in the Adopted Budget, and causes concern regarding the ability to achieve budgeted revenue levels. In addition the potential loss of all VLF backfill revenue, as noted below under Revenue from the State of California, would result in a lower cash flow and an additional decline in interest income. Continued close monitoring will be required in this category.



**GENERAL FUND (CONT'D.)**

**REVENUES (CONT'D.)**

**KEY GENERAL FUND REVENUES**  
(\$000's) (Cont'd.)

<u>Revenue</u>	<u>2003-2004</u> <u>Estimate</u>	<u>YTD</u> <u>Actual</u>
<b>Revenue from the State of California</b>	<b>\$ 47,895</b>	<b>\$ 5,466</b>

Revenue from the State of California through October totaled only \$5.5 million, which represented a significant decline from the prior year collection level of \$13.8 million. The drop of course reflects the impact of the reduction in Motor Vehicle In-Lieu Fee (VLF) payments included as part of the State budget balancing actions. (As a reminder, what was represented as a "one-time" impact resulted from the ramp-up time necessary to fully implement the increase in the VLF fees included in the State budget balancing package).

Actions were approved by the City Council in September to revise the budget estimate accordingly, resulting in a \$10.5 million decrease to the VLF category. Subsequent to the September re-balancing actions, however, it has been determined that a key assumption, based on State assurances, used to estimate prior year revenues in this category has also proven to be incorrect. Based on statements from the State Controller, the Finance Department presumed that a VLF payment in the amount of \$1.3 million due to the City in June, which was delayed, would eventually be paid. An accrual in that amount was, as a result, included in the final 2002-2003 closing statements. We since learned that, those assurances notwithstanding, this payment will not be forthcoming. The result is an additional shortfall of \$1.3 million in current year collection totals over and above any shortfalls resulting from the actions raising and then lowering VLF fees.

Of intense interest to the City of course, are the implications of the action of the new Governor rescinding the increase in VLF (retroactive to when it was raised) and the potential loss of all VLF backfill to the City, unless the Legislature passes VLF restoration legislation. The result of this action is the potential loss of an additional \$27.7 million on top of the \$10.5 million and \$1.3 million decreases noted above. It is still too early to be sure what action, if any, will take place at the State level. At this writing, however, the special session of the legislature called by the Governor to address this and other issues appears to have ended with no action to backfill VLF revenue loss. Should this prove to be the final outcome, the City will be forced to very quickly implement actions necessary to bring the General Fund budget back into balance.

**GENERAL FUND (CONT'D.)**

**REVENUES (CONT'D.)**

**KEY GENERAL FUND REVENUES**  
(\$000's) (Cont'd.)

<u>Revenue</u>	2003-2004 <u>Estimate</u>	YTD <u>Actual</u>
<b>Departmental Charges</b>		
<b>-Public Works</b>	<b>\$ 6,405</b>	<b>\$ 2,886</b>

Public Works revenues through October of \$2.9 million were 46.8% above the prior year level of \$2.0 million. While the best performing categories are residential engineering and non-residential engineering, nearly every category is performing better than it was through the same period last year. However, it remains unclear if this improved performance can be sustained over the rest of the year. The increased revenue is partially offset by lower than anticipated collections in the floodplain management and water quality runoff categories. The Budget Office will continue to work with the Department to project the year-end collection level, bringing forward appropriate adjustments, if necessary, as more information becomes available.

<u>Revenue</u>	2003-2004 <u>Estimate</u>	YTD <u>Actual</u>
<b>-Transportation</b>	<b>\$ 792</b>	<b>\$ 682</b>

Transportation Revenues of \$0.7 million tracked 210.7% above the prior year level of \$0.2 million. The strong performance has been driven by unanticipated one-time receipts for Signal Review in the North Coyote Valley, by higher than anticipated collections in the Miscellaneous Traffic Charges category, and by Residential Permit Parking collections which have tracked strongly at the beginning of this year due to permit renewals in the summer. The Budget Office will continue to work with the Department to project the year-end collection level, bringing forward appropriate adjustments, if necessary, as more information becomes available.

<u>Revenue</u>	2003-2004 <u>Estimate</u>	YTD <u>Actual</u>
<b>-Planning, Building, &amp; Code Enforcement</b>	<b>\$ 5,129</b>	<b>\$ 1,571</b>

Planning Permit revenue of \$1.6 million is well above last year's collection level at this point in time, and running at anticipated levels. Revenue activity for 2003-2004 assumed the same level of activity as 2002-2003, with increases of 15.0% as approved by the Council.

**GENERAL FUND (CONT'D.)**

**REVENUES (CONT'D.)**

**KEY GENERAL FUND REVENUES**  
**(\$000's) (Cont'd.)**

<u>Revenue</u>	<u>2003-2004</u> <u>Estimate</u>	<u>YTD</u> <u>Actual</u>
<b>Other Revenue</b>	<b>\$ 15,206</b>	<b>\$ 6,052</b>

Other Revenue collections of \$6.1 million were \$4.5 million above the prior year level of \$3.7 million. This increase from the prior year primarily reflects a planned increase in reimbursement from the Arena Authority. Overall collections appear to be within budgeted expectations.

<u>Revenue</u>	<u>2003-2004</u> <u>Estimate</u>	<u>YTD</u> <u>Actual</u>
<b>Transfers and Reimbursements</b>	<b>\$ 86,381</b>	<b>\$ 46,082</b>

Transfers and Reimbursement collections of \$46.1 million were significantly above the prior year level of \$34.4 million. This performance through October was primarily driven by various transfers to the General Fund, including transfers from the Healthy Neighborhood Venture Fund (\$10.0 million) and the Vehicle Maintenance and Operations Fund (\$2.9 million). Overall collections appear to be within budgeted expectations.

**EXPENDITURES**

Through October, General Fund expenditures of \$216.2 million were 1.5% below (down \$3.1 million) the prior year level of \$213.1 million. Encumbrances of \$42.8 million were 36.3% below (down \$24.4 million) the prior year level of \$67.2 million. Expenditures and encumbrances (\$259.0 million) through October constitute 35.6% of the total 2003-2004 revised budgeted uses of funds (\$728.1 million, excluding reserves).

On an overall basis, cumulative departmental and non-departmental expenditures appear to be within or below approved budgeted levels through October. In addition, only one department, the Fire Department, as described below, appears to be spending at a level that would exceed its appropriation at year-end.

**GENERAL FUND (CONT'D.)**

**EXPENDITURES (CONT'D.)**

The following discussion highlights General Fund expenditure issues:

**KEY GENERAL FUND EXPENDITURES**  
(\$000's)

<u>Department</u>	2002-2003 <u>Budget</u>	YTD <u>Actual</u>
<b>Police</b>	<b>\$ 226,489</b>	<b>\$ 69,934</b>

Overall, Police Department expenditures are tracking at slightly lower than estimated levels through October. In the Sworn Recruitment and Training Program, 33 Officers that were part of the January 2003 Academy were street-ready in October. Overtime expenditures through October were below expected levels at \$1.8 million or 24.8% of the budgeted level (compared to the estimated level of 32.2%). In February 2003, the Department implemented guidelines on overtime usage and the Department continues to be proactive in managing overtime usage.

The compensatory time balance at the end of October is 214,151 hours for sworn personnel. This level represents a drop of 5,244 hours (down 2.4%) from the June 2003 balance of 219,395 hours, but a slight increase from the October 2002 balance of 213,799 hours.

<u>Department</u>	2002-2003 <u>Budget</u>	YTD <u>Actual</u>
<b>Fire</b>	<b>\$ 113,263</b>	<b>\$ 36,000</b>

On an overall basis, expenditures for the Fire Department are tracking above budgeted levels. This is entirely the result of higher than anticipated departmental Personal Services expenditures, which appear to result primarily from the Department's current paramedic staffing situation, and the costs for Mutual Aid fire support provided to fight the Southern California wildfires. Early projections indicate that at current levels, year-end costs would exceed budgeted levels by as much as \$1.5 million. A portion of that overage should be reimbursed. In support of efforts to fight Southern California wildfires, the Fire Department dispatched four companies and support staff. The Department is currently obtaining further information on the total amount and timing for the reimbursement of these costs. Assuming full reimbursement for the Mutual Aid efforts, the department's year-end costs would be over the budgeted amounts by approximately \$1.0 million.

**GENERAL FUND (CONT'D.)**

**EXPENDITURES (CONT'D.)**

**KEY GENERAL FUND EXPENDITURES**  
(\$000's)

<u>Department</u>	<u>2002-2003 Budget</u>	<u>YTD Actual</u>
<b>Fire (Cont'd.)</b>	<b>\$ 113,263</b>	<b>\$ 36,000</b>

Efforts continue to address paramedic staffing levels in the department. As of the end of October, the Department has a total of 205 filled front-line (122) and support (83) paramedics. As discussed during last year's budget process, this front-line total is still short of the 147 that are necessary to fully staff all apparatus. During last fiscal year, the Department implemented several strategies to close the gap in front-line paramedics. In March 2003, the accelerated accreditation program for 13 Firefighter Paramedics resulted in an increase in the number of front-line Paramedics. In addition, 16 individuals have completed a Paramedic Academy and are in the internship phase of their training. A significant portion of the projected overexpenditure will, however, result from an unanticipated delay in the efforts to complete this certification process, which now appears to be at least four months behind. This will result in additional overtime costs of just under \$400,000. When the front-line Paramedics are accredited, the number of front-line Paramedics is anticipated to increase to a projected level of 133, still somewhat short of the full need. The remaining overexpenditure level appears to be related to that remaining imbalance. The Department will continue to work with the Budget Office to develop strategies to manage expenditures to end the year within budgeted levels.

**CONTINGENCY RESERVE**

Through October, the General Fund Contingency Reserve was \$22,986,675, down by \$2.1 million from the 2003-2004 Adopted Budget level of \$25,086,675. The following revisions to the contingency reserve were approved through October:

- A decrease of \$600,000 to provide an increase to the Hayes Mansion Conference Center Line of Credit in order to allow the Conference Center to remain open and operational while the City selects and completes negotiations with a new property manager.
- A decrease of \$1.5 million to provide or guarantee a letter of credit on behalf of the Silicon Valley Football Classic.

## **OTHER FUNDS**

### **Construction and Conveyance Tax Funds**

Continuing the positive trend experienced at the end of last fiscal year, Construction and Conveyance Tax collections through the first four months of the year were dramatically exceeding both prior year actuals and budgeted estimates. Tax revenues from this source are continuing to exceed expectations due to stronger than anticipated activity in the local real estate market. The number of property transfers for all types of residences in October increased almost 30% from October 2002, and these homes also took less time to sell with the average days-on-market decreasing from 76 days in October 2002 to 47 days in October 2003. Year-to-date property transfers have also increased by approximately 44% when compared to prior year activity.

Through October, \$9.1 million in actual tax revenues has been received (45.7% of the 2003-2004 estimate of \$20 million). This collection level was 71.5% higher than revenues received through October 2002. In addition to these revenues, the City has since received November Conveyance Tax receipts which totaled \$2.9 million. This result was 50.9% higher than the November 2002 amount of \$1.9 million. The 2003-2004 budgeted estimate, by contrast provided for a 19% decrease from the 2002-2003 collection level. The budgeted drop is, however, significantly higher than originally intended because collections in 2002-2003 were well above expectations (\$4.8 million). While the news remains positive, we should continue to exercise caution when projecting year-end receipts. The prolonged economic downturn could still begin to negatively impact housing sales, which are the primary drivers of this revenue.

### **Other Construction-Related Revenues**

After a first quarter during which revenue performance aligned fairly closely with estimates, October construction-related revenues were outstanding. The year-to-date total of the seven revenue sources monitored for this report is \$10.5 million, an increase of 30.7% from the \$8.0 million collected through the same period last year. This result was driven by a jump in residential activity caused by several large apartment projects, and by a jump in industrial construction activity. Industrial activity in October was the strongest month in the past two-and-a-half years. Despite October's strong showing, we do not believe that this indicates the arrival of any type of broad recovery in industrial activity. Such a recovery would appear to be at least several quarters away. Nevertheless, on an overall basis this activity has boosted revenues above year-to-date estimates for 2003-2004, which was built allowing for a 33.6% drop from the prior year's actual collections of \$30.0 million.

The revenue picture is somewhat mixed across sources within this category. The major revenue sources – Building and Structure Construction Taxes and Construction Excise Taxes – outperformed year-to-date estimates as well as prior year actuals. Building and Structure Tax receipts through October totaled \$3.6 million (49.9% of the current 2003-2004 estimate of \$7.3 million), which represents an increase of 27.1% from the revenues collected through the same period last year (\$2.9 million).

## OTHER FUNDS (CONT'D.)

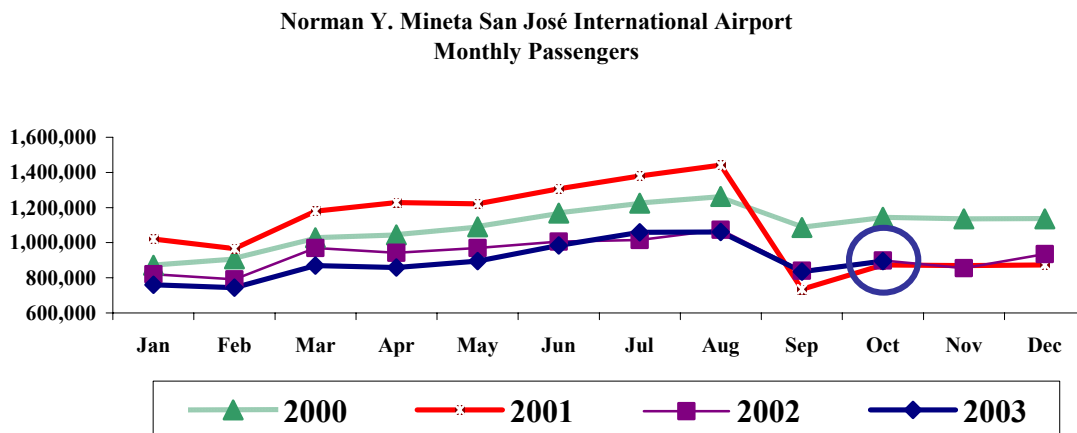
### Other Construction-Related Revenues (Cont'd.)

It should be noted, however, that the budgeted estimate for this category allows for a 32.4% drop in 2003-2004. Construction Excise Tax revenues through October totaled \$5.3 million (48.6% of the current 2003-2004 estimate of \$11.0 million), which represents an 18.9% increase from last year's \$4.5 million received over the same period. The budgeted estimate for this category allows for a 35.1% drop in 2003-2004.

Other construction related revenues are generated by Municipal Water Service Connection Fees, Sanitary Sewer Fees, Storm Drain Fees, Residential Construction Taxes, and Municipal Water Major Facilities Fees. All of these categories are tracking above prior year levels and are expected to end the year at or above estimates, with two exceptions. Municipal Water Service Connections Fees are currently tracking above prior year levels, but may end the year below 2003-2004 estimates. Municipal Water Service Connection Fees through October totaled \$11,000 (only 3.4% of the current 2003-2004 estimate of \$325,000). Because Service Connection Fee revenues recover actual costs to install new services, this low collection level is coupled with lower costs. In contrast, Municipal Water Major Facilities Fees are tracking slightly below year-to-date estimates. However, current projections indicate that these revenues will meet estimates by the end of the year. Municipal Water Major Facilities Fees through October totaled \$31,000 (30.9% of the current 2003-2004 estimate of \$100,000). Staff will continue to monitor these revenues closely.

### Airport Funds

On a year-to-date basis, the Norman Y. Mineta San José International Airport (SJC) has enplaned and deplaned 3.85 million passengers, an increase of only 0.5% from the figures reported through October for 2002-2003. All of this growth was due to increased July activity. Monthly passenger activity for October was down 0.5% from 2002 levels. Passenger activity continues to be adversely impacted by the downturn in the local business and high-tech economy, as well as aviation industry-wide scheduling cutbacks. In October 2003, the Airport served 894,225 passengers.



## **OTHER FUNDS (CONT'D.)**

### **Airport Funds (Cont'd.)**

Terminal C passenger activity for October 2003 increased 4.3%, while year to date activity increased 6.8% from October 2002. Terminal C air carriers reporting reduced passenger totals are Continental, Northwest, and United. Those experiencing passenger growth include Alaska, American Trans Air, Horizon, Delta, Mexicana, America West, and Skywest. Frontier Airlines, which began full operations at SJC in November of 2002, has added 41,791 passengers to the total this year. Terminal A activity decreased 3.1% in month-to-month comparisons and is 2.7% lower than 2002-2003. Although American Eagle and Southwest reported increases in activity, the decrease in activity for American Airlines was almost 25.0% from 2002 passenger levels.

Mail, freight and cargo totaled just under 80 million pounds, which represented a 23.4% decrease from 2002-2003. The decrease is largely attributable to the termination of operations of Emery Worldwide Airlines and Kitty Hawk Air Cargo, although all cargo carriers showed reduced levels of activity in the current fiscal year. October 2003 taxicab operations decreased by 2.2% from those in October 2002, and are 3.1% lower than those recorded year to date in 2002-2003. A positive sign in activity was visible in Passenger Facility Charge (PFC) revenues for tickets purchased through September. Year to date receipts are 2.5% higher than 2002-2003 and are 5.7% greater in a month-to-month comparison.

Year to date operating revenues increased by \$7.2 million for October 2003 but were not sufficient to outpace the forecast, as total revenues were 4.0% lower than the prorated budget. Performance of various revenue categories showed mixed results. Revenues posting higher results than the prorated budget were terminal rentals, airfield, as well as parking and roadway. Terminal rentals were 5.0% higher than the budget due to additional space occupied by Southwest Airlines. Airfield revenues continued to outpace the prorated budget because of the rise in the activities of the commuter airlines. Parking and roadway revenues tracked slightly higher than the prorated budget, mainly due to increased activities in short term parking.

Revenues that tracked lower than the prorated budget included landing fees, terminal concessions and miscellaneous rents, general and non-aviation, and the petroleum program. Lingering weak passenger traffic caused the airlines to decrease flight activities that correlated to lower landing fees. Terminal concessions and miscellaneous rents lagged 12.0% below the prorated budget mainly due to lower concession fees collected from the rental car companies and other concessionaires at the terminals. General and non-aviation revenues were down by 27.0% because the Airport no longer receives reimbursement from the Transportation Security Administration after the elimination of the requirement to have law enforcement officers at the security checkpoints effective June 1, 2003. The petroleum program was just 88.0% of the budget because of the cessation of operations by Kitty Hawk and Charter America that accounted for 20.0% of the prior year's jet flow fees collection.



## **OTHER FUNDS (CONT'D.)**

### **Airport Funds (Cont'd.)**

Through October, expenditures in the Airport Maintenance and Operations Fund are tracking below budgeted levels in both Personal Services and Non-Personal/Equipment categories. In Personal Services, expenditures totaled 30.1% of budget compared to a prorated benchmark of 32.2%. Savings are attributed to departmental vacancies and reduced overtime expenses. Through the end of October, the Airport carried 68 vacancies, of which 40 were funded. Of these funded vacant positions, seven are funded in the Airport Capital Budget and do not impact Personal Services expenses in the Maintenance and Operations Fund. Vacancy savings are partially offset by three pool employees and one overstrength position.

Overtime expenditures to date total \$41,000 (or just 10.2% of budget), as compared to \$42,000 spent year to date in 2002-2003. Overtime at the Airport is used to provide critical holiday coverage, after-hours support, maintain mandated staffing levels and provide emergency response. For the most part, October 2003 overtime was related to staffing necessary to manage vehicle and pedestrian traffic in front of the terminals to ensure the safety of our customers and minimum staffing levels necessary to staff services for the October 13th holiday. Paid overtime for Airport employees for October 2003 totaled \$19,000, as compared to \$20,000 paid in October 2002.

Non-Personal/Equipment expenditures through October were \$7.1 million, or just 17.5% of the 2003-2004 Non-Personal/Equipment budget. Current encumbrances amount to \$11.5 million, which brings total commitments to \$18.7 million, or 45.9% of budget. Actual expenditures for this period are well below the Airport's prorated Non-Personal/Equipment benchmark of 25.5%. In particular, lower than estimated expenditures have been recorded in contractual services, where only 15.6% of the budget in this category has been expended. At this time, any Non-Personal savings recorded to date should be viewed as preliminary. Additional encumbrances and outstanding obligations have been identified in the contractual services detail that could increase the rate of expenditure, bringing total expenses to benchmark levels. Expenditure data through October should be considered within budget.

Year to date revenues from the Airport Customer Facilities and Transportation Fee Fund total \$1.1 million. These total revenues are 0.5% less than year to date 2002-2003 levels and are 1.8% less than anticipated. Expenditures in the fund total \$1.3 million and are 2.3% greater than expenses through October 2002, but remain 18.8% less than the benchmark level of 28.2%. Expenditures are tracking lower than anticipated due in large part to careful management and reduced bus operator, maintenance and fuel costs. Although it is too early to say definitively that expenditure reductions or additional revenue will be needed, this fund relies primarily on fees generated from business travelers. If activity does not rebound somewhat, further expenditure reductions or quarterly revenue contributions from the rental car companies may be required to fund the costs associated with adequate customer services to and from the Rental Car Facility.

## **OTHER FUNDS (CONT'D.)**

### **Transient Occupancy Tax Fund**

Transient Occupancy Tax (TOT) collections of \$1.1 million through October were down 8.5% from the same period last year. As described earlier, the October 2003 occupancy rate in the largest hotels of 50.42% was down slightly from the October 2002 rate of 55.84% and below the September 2003 rate of 51.4%. In addition, while the number of rentable rooms remained stable over the prior year, the average room rate continued to slip, dropping to \$115.96 in October 2003 from \$127.27 in October 2002.

Based on these trends, it would appear that collections in this fund will end the year well below the \$6.7 million budget. Staff will continue to monitor this fund closely, but we believe a downward adjustment in this fund will prove necessary at mid-year. This was apparent several months ago and the three recipients of the proceeds of this fund placed on notice that further reductions in their budgeted allocations will likely be necessary.

### **Integrated Waste Management Fund**

Overall, Integrated Waste Management Fund revenues are tracking to end the year at 1.5% below estimate, primarily due to customers downsizing their carts in both Single-Family and Multi-Family Dwelling sectors further than anticipated. However, it is expected that related expenditure savings will compensate any shortfall in revenue.

## **CONCLUSION**

Economic indicators and City revenue collections confirm the fact that the City continues to be mired in an economic slowdown and will likely remain so for the immediate future. Since the Adopted Budget assumed this situation, we believe that performance to date is consistent with budgeted estimates. Although the breadth and depth of the weak local economy has clearly been greater and longer than any of us anticipated, to date we have been able to weather the situation relatively well, largely due to the aggressive management measures implemented as soon as it became apparent that the economy had peaked.

Obviously, at this point however, the largest danger facing the City is external -- the loss of VLF revenue and the apparent stalemate at the State level concerning efforts to prevent the drastic impact on local government services statewide if the backfill is not restored. The \$28 million hole in the City of San Jose's 2003-2004 General Fund budget that would result, will require swift and painful actions to bring City finances back into balance. Contingency planning for that outcome is in progress.

**CONCLUSION (CONT'D.)**

Regardless of the outcome of the current State process, tough decisions lie ahead. Planning has been under way for some time within the Administration to develop options for how to address next year's situation. Those efforts will have to be greatly accelerated should the VLF backfill fight be lost. We remain confident, however, that no matter how large the problem we face, our track record of prudent financial planning will continue to serve us well, and that working together we can and will respond appropriately.

As always, staff will continue to closely monitor our current year financial status and report regularly to the City Council on any and all significant developments through this reporting process.

LARRY D. LISENBEE  
Budget Director